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Resale Communications Carriers (SB 375)

Senate Committee on Energy and Public Utilities

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In the Matter of:)
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RESALE COMMUNICATIONS)
CARRIERS (SB 375))

TUESDAY, OCTOBER 25, 1983
9:30 A.M.

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INTERIM HEARING
CALIFORNIA LEGISLATURE
SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

In the Matter of:)
RESALE COMMUNICATIONS)
CARRIERS (SB 375))

SANTA MONICA CITY HALL
COUNCIL CHAMBERS
1685 MAIN STREET
SANTA MONICA, CALIFORNIA

TUESDAY, OCTOBER 25, 1983
9:30 A.M.

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SACRAMENTO, CALIFORNIA 95825
TELEPHONE (916) 972-8884

MEMBERS PRESENT

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES:

Senator Herschel Rosenthal, Chairman

Senator Newton Russell, Vice Chairman

Senator Joseph B. Montoya

ALSO PRESENT:

Timothy Davis, Principal Consultant

Ann Gressani, Associate Consultant

Patricia Stearns, Committee Secretary

John Fossette, Legislative Counsel

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P R O C E E D I N G S

--oOo--

CHAIRMAN ROSENTHAL: Good morning. This meeting of the Senate Energy and Public Utilities Committee is a continuation of our hearing from yesterday on telephone service after divestiture. Today we will be examining the provisions of my SB 375, which would affect the regulation of resale communications carriers. It should result in further competition in the communications market and therefore be beneficial to the public.

However, before bringing the bill up for a vote, it was my belief that this interim hearing should take place in order for the provisions of the bill to be thoroughly discussed by all interested parties. Following the hearing, I will decide whether this bill merits further consideration, and, if so, what amendments may be needed. Again, today, I ask that witnesses be as brief as possible in order to allow some questions.

We'll start with the agenda. The witness is Kerry Fox, President of United States Telephone Long Lines, Incorporated.

MR. FOX: Good morning, Mr. Chairman and Members of the Committee. I am Terry Fox, with U.S. Telephone - one of the companies which provides telephone services principally by reselling the services of other carriers, more commonly known as a reseller. I would like to thank this Committee for the opportunity to present our views concerning the important

1 issues raised by Senate Bill 375 - legislation which is
2 intended to establish rules for the regulation of resale
3 communications carriers. These issues involve considerations
4 which are critical to both users and providers of tele-
5 communications services within the state, and we greatly
6 appreciate the invitation to present our views.

7 Before I respond to the specific questions addressed
8 by the Committee to our company, I would like to say a few
9 words about Senate Bill 375, which you, Mr. Chairman, graciously
10 agreed to author. Our company is sponsoring SB 375 in order
11 to provide a clear statutory framework for the provision of
12 services to Californians by resellers. The present provisions
13 of law, with regard to the regulation of telephone companies,
14 were designed to regulate additional telephone companies that
15 enjoyed monopoly status within their service areas.

16 Today, however, California and the rest of the
17 nation have entered the era of competition in the provision
18 of long distance telephone services. Well-publicized court
19 and federal regulatory provisions have provided the consumer
20 with a choice of a variety of long distance carriers.

21 Our company, and other resellers, are looking forward
22 to providing those services to the California consumers on an
23 intrastate basis.

24 The present regulatory framework as embodied in the
25 California Public Utilities Code is simply not designed to
26 accommodate the orderly entry of these competitive carriers
27 into the intrastate market. The code is designed to regulate
28 monopolies; and for the dominant long-distance carriers in

1 California - AT&T and Pacific Telephone - that is a form of
2 regulation which will continue in our opinion to be appropriate.
3 However, for resellers who are competitors of AT&T and Pacific
4 Telephone, as the FCC has found, a lesser form of regulation
5 should be required.

6 It is possible that the Commission could institute
7 the lesser form of regulation on its own by simply forbearing
8 from exercising its jurisdiction. That is the approach that
9 the FCC has adopted. We believe, however, that a great deal
10 of confusion and legal uncertainty can be avoided by simply
11 recognizing the existence of the smaller competitive carriers,
12 and providing a statutory framework for their supervision
13 by the PUC. This is precisely what SB 375 does.

14 Senate Bill 375 establishes the statutory classifi-
15 cation of resale communications carrier, a carrier who provides
16 telephone service in California principally by reselling the
17 services of others. Under the provisions of SB 375 these
18 carriers will be provided operating authority by obtaining a
19 license from the PUC, in accordance with a simplified appli-
20 cation procedure. This will allow them to enter the market
21 smoothly, without being required to undergo the tremendous
22 regulatory burdens which are attendant to the receipt of the
23 traditional Certificate of Public Convenience and Necessity,
24 designed for monopolies.

25 While the Bill will thus permit resellers to enter
26 the market and provide their services to California consumers,
27 it will not simply be an open door for intrastate operations
28 by resellers. Resellers licensed by the Commission will be

1 required to satisfy financial responsibility requirements
2 established by the Commission. They will further be required
3 to obtain a performance bond. They will be required to file
4 tariffs with the Commission, setting forth the rates and
5 charges; and, perhaps more importantly, they will be subject
6 to the Commission's complaint procedure.

7 The Bill provides that the Commission, either on its
8 own or pursuant to such a complaint, may revoke the license
9 of the resale communications carrier for failure to comply
10 with the Commission's rules, or for engaging in false advertis-
11 ing or false representation.

12 We at U.S. Telephone believe it is essential that the
13 resale industry be provided a clear statutory basis for the
14 operation under the Commission's supervision.

15 California consumers will be able to enjoy the savings
16 resellers can provide while, at the same time, according the
17 protection of the Commission. We urge the Committee to
18 support SB 375. Now going on to some of the questions that
19 were raised to our company, as well as others, I would like
20 to review several questions that were raised in connection with
21 the Bill. I will certainly not attempt to answer all these
22 questions verbally, in the interest of time, particularly
23 since they are covered in our prepared statement that will be
24 given to the Committee.

25 First, what is a reseller? We all know, basically,
26 a reseller is a company providing long distance telephone
27 service to the public using bulk facilities obtained from
28 other carriers. We provide, for example, service from service

1 originating areas in the Southwest, Midwest, Northeast, and
2 Western United States.

3 The larger resellers - such as U.S. Telephone - are
4 able to offer their customers significant savings as a result
5 of effective Least-Cost Routing within their networks. We
6 are able to accomplish this by buying circuits at bulk rates.
7 The majority of our customers are small business users who,
8 through our services, are able to enjoy the benefits of bulk
9 purchase that previously had only been available to very
10 large purchasers.

11 To achieve competitive service offerings in our
12 business, and the operating resources to remain viable,
13 resellers generally operate -- enter into long-term leases of
14 transmission capacity for their present and planned future
15 transmission needs. Even with the ability to lease trans-
16 mission facilities from others, our business is very capital
17 intensive and requires very substantial long-term commitments
18 for the Switching, Call Processing, Circuit Testing and
19 Billing Accounting Equipment that goes along over and above
20 the transmission equipment itself. For example, our capital
21 budget for the next two years is in excess of \$100 million.
22 So, even without the transmission facilities themselves, our
23 commitments to the areas we serve is certainly very long-term
24 in nature.

25 We feel that we help the traditional carriers by
26 better utilizing not only the local exchange facilities, but
27 also the access long distance toll facilities that are available
28 in this country, rather than building our own to compete against

1 them. We feel that this provides an economy of scale in the
2 more efficient use of these facilities which should promote a
3 lower unit cost for their other users.

4 Certainly, with the present long distance revenues
5 exceeding \$45 billion annually and growing today at a rate of
6 some 10 to 15 percent per year, the total annual revenues of
7 all the other long distance carriers put together represents
8 something less than four percent of the total, or less than a
9 third of the expected average gross rate each year.

10 Putting it another way: Those of us in this
11 building find that we can live very comfortably, and still do
12 an excellent job of providing competitive service to our
13 customers with what the Bell System drops between the desk and
14 the wall on a bad day.

15 Let's take a minute and look at some of the questions
16 that were raised. First, the question of access. On
17 January 1 - the question was - will your company require
18 access numbers and push-button phones to continue to provide
19 service?

20 Yes, both U. S. Telephone and other companies in
21 this business will continue to require access numbers. As
22 you know, when a subscriber picks up his telephone and obtains
23 a dial tone, he dials an ordinary seven-digit local number
24 which is the access number into the switch, which we provide,
25 or which our competitors provide, serving that particular
26 locality - such as here in Los Angeles. When the U.S.
27 Telephone switch "answers" it provides a second dial tone
28 that basically indicates to the subscriber that he has reached

1 that switching facility. He then dials a personal authori-
2 zation code of five to seven digits, followed by the normal
3 ten-digit number he is attempting to call - that is the three-
4 digit area code and the seven-digit number of the called party.

5 Therefore, the U.S. Telephone subscriber continues to
6 be required to dial from 22 to 24 total digits to complete his
7 call, versus 11 with AT&T, obviously a competitive disadvantage
8 in comparison with AT&T.

9 This requirement of dialing additional digits, as
10 well as other competitive disadvantages which I will discuss
11 in just a moment, are a result of an inferior inter-connection,
12 or poor inter-connection to the local exchanges which long
13 distance competitors are provided in comparison to that given
14 AT&T. Ultimately, equal access will hopefully eliminate those
15 differences, but that will only begin in 1984, and we will see
16 no significant results of that until 1986 or beyond.

17 As it turns out, this also restricts U.S. Telephone
18 and other resellers from a large segment of the California
19 market. This has to do with the availability of rotary
20 telephones, which I think you are certainly familiar with.
21 But, basically, unless a subscriber's rotary telephone can be
22 equipped with some special attachment, we cannot provide
23 service to those customers who have rotary telephones; and
24 that comprises some 42 percent of Pacific Telephone's market
25 in California. We do have a device called a system access
26 module - a small micro processor - with which we can provide
27 access to the system. But that's an additional cost item that
28 costs something in excess of \$200, and certainly puts that use

1 and that access into the system at a competitive disadvantage.

2 The next question: Will your customers be able to
3 call anywhere in the country?

4 The answer is yes. We have very competitive long
5 distance service to all points in the contiguous United States,
6 Hawaii, Puerto Rico and the U.S. Virgin Islands. With one
7 major service originating area located in Los Angeles and with
8 one planned for San Francisco in the near future, California
9 subscribers will be able to call anywhere in the country.

10 However, U.S. Telephone's ability to provide service to other
11 cities in California is dependent on the resolution of several
12 major issues presently before the California Public Utilities
13 Commission, including the permissible resale of WATS service.

14 The third question that I would like to touch on is:
15 How will customers be able to know when the long distance call
16 they are making will be provided by the local telephone
17 company or one of the long distance carriers, and, if so,
18 which of the various access numbers to use?

19 Well, as of the time of divestiture, of course,
20 unless a customer specifically subscribes to one of the carriers
21 other than AT&T and actively pursues that by dialing all the
22 additional digits that I just spoke of, and all of the inter-
23 LATA calls will be automatically routed over AT&T facilities.
24 Therefore, in order for a subscriber to subscribe to long
25 distance services from one of the competing carriers, the
26 subscriber will again be required to dial the local access
27 number for each carrier as well as each individually tailored
28 multi-digit authorization code. Again, a much more complicated

1 procedure than with AT&T.

2 The fourth question is: Won't AT&T have a definite
3 competitive advantage as of the time of divestiture? The
4 answer, of course, is yes. AT&T will enjoy significant
5 competitive advantages, and I might just summarize a couple of
6 these:

7 First, the customers of the local telephone companies
8 have automatic access to AT&T toll services. They receive
9 directions in their telephone book as to making calls and they
10 are billed directly for AT&T services by their local telephone
11 company. Prospective customers of competing carriers must
12 actively decide to convert their service from AT&T to a
13 competing carrier, and when they do, these customers will then
14 receive separate bills. Of course, again, an inconvenience.

15 Customers using AT&T-provided services will be
16 required to dial 11 digits; the subscribers of everyone else
17 will be required to dial anywhere from 23 to 24 digits.

18 Generally, an end user must have a touch-tone
19 telephone, which I talked about earlier.

20 The quality of access to the local telephone network
21 is a significant issue. It certainly will continue to be
22 poorer than that provided by AT&T. Not to get too technical,
23 but, for example, as competing carriers we will continue to
24 experience such problems as the lack of automatic number
25 identification; the lack of supervision - that is, to know
26 when the called telephone is actually picked up and conversa-
27 tion begins - difficulties with echo; and, perhaps more
28 important, excessive and variable transmission loss, which

1 impairs the ability to communicate, particularly on the
2 longer haul circuits from coast to coast.

3 Customers who do not pay AT&T can have their local
4 telephone service terminated. Obviously, an excellent ability
5 if people don't pay, whereas companies who compete against
6 them cannot do that. They do not have that capability.

7 Overall, you might say we face a significant uphill
8 battle because AT&T enjoys such a dominant and entrenched
9 market position in the overall field of telecommunications.

10 The last question, of course, was the issue of our
11 position on Senate Bill 375. I touched on that, I think. We
12 feel that it recognizes that virtually no regulation of rates
13 or services is necessary because of the competitive nature of
14 the resale industry. With the numerous resellers entering
15 the business, we feel that competition here is very beneficial,
16 in that it will drive prices toward costs and truly spur
17 creativity.

18 We feel that SB 375 is of importance not only to
19 all California consumers but to the total communication
20 industry as well, because it provides the consumers with a
21 greater freedom of choice and an increased product offering
22 and lower prices.

23 With that, I would like to thank you for your time
24 and attention. If you have any questions about our company
25 or its business, or any of the comments I have made, I'll try
26 my best to answer.

27 CHAIRMAN ROSENTHAL: Mr. Fox, what is the present
28 status of the federal regulations of resale carriers?

1 MR. FOX: Are you talking now of the FCC 7872?

2 CHAIRMAN ROSENTHAL: Right.

3 MR. FOX: As you know, there has been an Order for
4 Reconsideration that has, in our view, made the AT&T position
5 as a dominant carrier even stronger. There has been a great
6 deal of discussion. Our company, as well as the industry, many
7 others in the industry have met with the FCC, and it is my
8 opinion that that will be evaluated and possibly reconsidered
9 again.

10 Obviously, we will have to wait. As you know the
11 provisions have been extended now from January 1st to April
12 1st, giving three additional months for that to be considered.
13 So it is particularly difficult for, I guess all of us in
14 this industry to try to make our forward plans, because of
15 the lack of clear understanding of exactly what is going to
16 happen there.

17 CHAIRMAN ROSENTHAL: Thank you very much. Any
18 further questions?

19 SENATOR RUSSELL: No.

20 MR. FOX: Thank you.

21 CHAIRMAN ROSENTHAL: I would like to indicate that
22 Senator Newton Russell has joined the Committee.

23 We'll go on now to Richard Carr, President of the
24 California Association of Long Distance Telephone Companies.
25 I assume you are not going to repeat what has already been said.

26 MR. CARR: I will not repeat that, I gather, then
27 not only today but on other days; you have heard much of that
28 and there might be a few parts of it I will touch on. But I

1 will try to avoid what is in my prepared -- my prepared text
2 that relates to what Kerry Fox talked about.

3 In fact, I just need to emphasize that by and large,
4 when he was talking about those technical aspects of the
5 business or any of the other aspects of the business, we would
6 concur with that.

7 I would like to thank you very much for the
8 opportunity to be here. I wear two hats standing before you:
9 I am president of ComPath Network Services, which is a smaller
10 reseller compared to U.S. Telephone, but large compared to
11 some of the small business here in the state. So, we operate
12 in the Oakland and the San Francisco Bay area, and we have
13 plans to also open an office down here in Los Angeles.

14 I am also president of the California Association
15 of Long Distance Telephone Companies, and that is a new
16 association, currently with 12 or 13 members, all resellers
17 here in the state of California; and we have another dozen
18 or so members, or potential members, who have been coming to
19 some of our meetings, who are interested in joining our
20 organization. And we are right now reaching out to other
21 resellers in the business, to try to form a strong association
22 here in the state of California, because so much of our future
23 is dependent on both legislative and regulatory activities here
24 in the state of California. And, the rest of 1983 and 1984
25 are going to be very, very important to our ability to offer
26 service.

27 You have a copy, I think, of my testimony. I'm going
28 to just hit on a couple of points that I think are very

1 important. One is, why does California need resellers?
2 Competition is here whether the people like it or not. What
3 the FCC has done and what Judge Greene has done is basically
4 create a competitive environment in the telephone communications
5 industry; and we need to operate in ways so that the users of
6 telecommunications get not only some of the hardships that seem
7 to be inherent in that deregulation, but all of the benefits
8 of the deregulation and changes in the telecommunication
9 industry.

10 One of the concerns, of course, that we have has to
11 do with just the long distance aspect of the -- of the
12 deregulation of the industry. And, as I look at it, there are
13 three -- or will be three categories of long distance providers.
14 Obviously, there is AT&T Long Lines as an interchange carrier.
15 I think we all are quite familiar with AT&T; they are
16 dominant - and I don't mean that in the regulatory sense;
17 they are a very large and strong company with somewhere
18 between 90 and 95 percent of the long distance market today.

19 Today, they are in essence sort of the assumed
20 provider in the business today because they are so large, they
21 have been entrenched for years. They are coming out of the
22 monopoly status. But, basically, they have been the provider
23 of long distance telephone services. So, they are one of the
24 types of providers of this service.

25 A second type of provider is relatively new companies
26 - MCI, Sprint and, in the Bay area, Western Union. They are
27 facilities-based carriers. Unlike us resellers, as Kerry
28 Fox was describing, they are basically facilities-based

1 carriers, although they do some reselling also. And they are
2 relatively large companies. They are either parts of large
3 companies, or they have grown rapidly and become large
4 companies. So that is a second category of companies. And,
5 if California were to stop with only those two categories of
6 long distance provider, I think California then would end up
7 with just a few competitors in the long distance market. I'm
8 not sure if that would be three or four; depends on who may
9 be in the place. But there would certainly not be as many as
10 there might otherwise be.

11 In fact, some of the cities of California - I'm
12 thinking some of the, not small, but some of the smaller
13 cities in California - might be in the position of having
14 service only from AT&T, or AT&T plus one of these larger
15 providers. So, I think resellers entering that arena provide
16 an additional competitive thrust, both in the sense of price
17 and added services. Today operating in California it is a bit
18 difficult to count the number of resellers, because it is a
19 very young business; but there are 30 resellers in the business
20 in the state today, and probably closer to 60 if we count some
21 of the companies just getting into the business. So, resellers
22 provide a dimension of competition in both pricing and in the
23 service offerings.

24 I doubt that some of the larger facility base
25 carriers would be as aggressive with offering universal intra-
26 state services as they are today, if it weren't for the prod
27 they received from resellers who, through their use of WATS,
28 automatically provide a universal service throughout the state.

1 And I think without resellers there will be parts of the state
2 that will really have no alternative or no competitive service
3 without resellers. So, I think the state needs resellers
4 to enhance the competition, to gain the benefits of the new
5 deregulated environment.

6 Now, resellers need the bill that we are discussing
7 here - they need SB 375 - really to ensure their ability to
8 compete, to ensure their survival; and they need it very soon.
9 It is a young industry, as Mr. Fox described; it is a
10 capital intensive industry. It is an industry where people
11 need to get up and running or they are not going to be in
12 business.

13 In the current unsettled state of the ability or
14 inability to offer intrastate service dramatically curtails
15 the ability of resale carriers to compete with AT&T, to
16 generally get and hold customers. So, to provide intrastate
17 service in the future, really what the reseller is asking and
18 what people in my association are asking, is to be recognized
19 by the PUC as would be done in this bill, and to provide the
20 authority to operate within the state of California; and for
21 that to be done in a way where there is modest paperwork and
22 red tape.. Most of the companies that are resellers are
23 relatively small and don't have the type of staffs that it takes
24 to deal, as the telephone company does, with the PUC. So,
25 Bill 375 really is an important step in the reseller's ability
26 to move into the marketplace and succeed.

27 Do you have any questions?

28 CHAIRMAN ROSENTHAL: Let me ask a question. With

1 the number of new companies coming into the field, what is
2 the protection to the consumers in terms of those companies
3 going broke or not being able to provide the service?

4 MR. CARR: In a broad sense, there is little
5 protection from that. On the other hand, the question gets
6 down to: What is the harm done then to the consumer?

7 The typical user of the services does not pay any
8 up-front fees. Basically, the user pays for the calls that
9 they make.

10 If the provider were to go out of business, or in
11 some other way not be able to provide the service, in
12 essence the consumer has not prepaid for the service, so the
13 consumer, as I would look at it, would not be hurt in that
14 situation. In fact, maybe even in a situation of the -- if
15 the reseller were bankrupt, the reseller would have a difficult
16 time collecting for services already provided. So, I don't
17 see how that would harm the consumer.

18 On the other side of that is: What is the likeli-
19 hood of that happening? A more probable case of a reseller
20 in trouble, financial trouble, is that it would be acquired
21 by another reseller who is looking to expand its own
22 customer base. And some of that has already been going on in
23 other states of the nation. I'm not sure there is much
24 danger.

25 I also wanted to comment on one thing that -- on a
26 question that you asked Mr. Fox. It had to do with the
27 current regulation of resellers. Another aspect of that is
28 that initially the federal government, the FCC through their

1 214 provisions, asked for a licensing of resellers. And,
2 after dealing with better than 200 and something resellers,
3 they decided that having these types of licensing requirements,
4 which were fairly extensive, were not necessary. And, in
5 that sense, deregulated resale allowed the use of resale
6 intrastate and allowed the use of specific resale of WATS
7 service intrastate.

8 CHAIRMAN ROSENTHAL: Any questions from the
9 Committee?

10 SENATOR RUSSELL: No.

11 CHAIRMAN ROSENTHAL: Thank you very much. Our next
12 witness is Duncan Wyse, Director for Policy and Planning
13 Division of the Public Utilities Commission.

2 14 MR. WYSE: Good morning, Mr. Chairman. Yesterday, I
15 included in the testimony submitted to you, your question on
16 resale. The Commission has taken no position on SB 375. The
17 regulation of the resale carrier industry is an issue that we
18 are currently considering in our investigation into
19 competition in the state of California. The Commission, as I
20 mentioned yesterday, has not completed that investigation.

21 We have had two months of evidentiary hearings, which
22 are just about completed, and we expect to reach a decision
23 sometime early next year.

24 One of the issues in that proceeding is the question
25 of resale, and what the consequences of resale would be toward
26 the consumers in California. I wish we had a decision for you
27 to look at, but unfortunately the Commission has not reached
28 a decision on this issue. As, similarly, to the general issue

1 of competition, the arguments for resale are that you provide
2 diversity of choice to consumers - new options, greater
3 competition in the industry.

4 The other side of the question is what the resale
5 carriers may do in the development of competition in the
6 communications market, what implications that would have for
7 the level of local telephone rates and the universal afford-
8 ability of service. That is fundamentally the issue that we
9 are trying to address in our investigation - what the
10 consequences of competition will mean on the rates in the
11 future, versus the potential for enhanced technology and
12 diversity of choice.

13 I guess it is -- well, I guess it is -- while the
14 Commission has taken no position, the staff would recommend
15 that you may want to wait until the Commission has reached
16 its decision on competition generally, to take a look at the
17 framework that the Commission is developing. That is a
18 possibility of how to handle this matter.

19 I would point out one aspect of this issue is that
20 it is not clear what resale is. In your bill it defines
21 resale as any corporation or person owning or controlling or
22 managing any service which provides telephone service for
23 compensation principally while reselling to public communi-
24 cations services provided by the telephone corporation, and
25 so on. "Principally" is the key word there insofar as resale
26 carriers do invest in facilities; they become like, in many
27 respects, other common carriers, which then blends into the
28 whole issue of competition, and -- which is really one of the

1 complicated features of this whole industry. And, as we try
2 to understand the competitive rules and going forward, these
3 are all issues we will try to address in our investigation.

4 I would be happy to answer questions.

5 CHAIRMAN ROSENTHAL: I guess until we know what the
6 regulations are, we won't know whether 375 will undercut those
7 or not. And you are suggesting that we wait.

8 When is it expected that you will have those
9 regulations? If it is into the second year of the session,
10 that means that bills have very little time in the two houses.
11 If in fact we go ahead with the bill, with the idea that there
12 will be changes made, what would be your position on that?

13 MR. WYSE: Well, the Commissioners realize we need
14 a new framework for the industry, after divestiture, on
15 competition; and it has given as accelerated a schedule for
16 reaching a decision on the competition question as we really
17 can.

18 We truncated the hearings. We set a definite dead-
19 line. The hearings should end this week on the competition
20 question, and the Commission will then proceed after briefings
21 to reach a decision. We hope to have a decision as early next
22 year as we can.

23 CHAIRMAN ROSENTHAL: Do you think that this legisla-
24 tion will require an increase in residential rates?

25 MR. WYSE: Well, that is the issue in the competition.
26 The argument that is made is that the long distance competitors
27 in general are picking the cream routes and rerouting the
28 revenue sources that are used to support basic rates -

1 essentially, the toll routes which have been traditionally
2 used to contribute to the basic monthly telephone service.
3 That is the argument.

4 We are looking at the subsidy question in our
5 hearings, to try to get an understanding of how great a subsidy
6 source that may be. It is certainly conceivable that other
7 common carriers and resale carriers put pressure on rate
8 design and could conceivably have an affect on local rates.

9 CHAIRMAN ROSENTHAL: Is it likely that the PUC
10 would carry out the intentions of SB 375 without the bill?

11 MR. WYSE: Well, I wish I could -- Until we know
12 what the framework we want to develop is, it is conceivable.
13 I don't know the answer because the Commission hasn't reached
14 its decision on what it wants to do on competition.

15 SENATOR RUSSELL: Following up on that, is it
16 necessary to have this bill for you to do the kinds of things
17 that are in the bill, if the PUC were to decide that that is
18 a good thing to do?

19 MR. WYSE: I think if we wanted a liberalization of
20 resale, I think some of the provisions would simplify it, the
21 licensing. I think we could -- but I do think we could grant
22 certificates to resale carriers, and, for example, the radio-
23 telephone area we recently relaxed the rules for entering into
24 that industry, and I think there is flexibility in terms of
25 relaxation of entry rules should the Commission wish to do so.

26 SENATOR RUSSELL: So, if the worst were to happen
27 and the author decided that you had not moved, and he couldn't
28 get his bill out, or whatever, and he then later decided that

1 what the bill provided was a good thing to do, the PUC on its
2 own could go ahead and do the kinds of things that the bill
3 authorizes?

4 MR. WYSE: I think so, although there may be some
5 advantage in terms of the procedures outlined in the bill. I
6 think there is the flexibility at the Commission, in terms of
7 granting licenses, that we could streamline the process should
8 that be the course.

9 This would be framework establishing legislation
10 which, if that is the choice of the Legislature to streamline
11 the process, would clearly set out the rules for doing so for
12 the Commission.

13 SENATOR RUSSELL: Thank you.

14 CHAIRMAN ROSENTHAL: Well, I guess the bottom line
15 is: I hear what you are saying, that you could do these things;
16 and I guess those who are in support of the legislation would
17 rather have it in statutes of some kind so that doesn't change
18 in terms of --

19 MR. WYSE: That's right.

20 CHAIRMAN ROSENTHAL: -- what they are doing. If we
21 proceeded with the legislation, it wouldn't interfere with
22 whatever you had to do in terms of studying the situation?

23 MR. WYSE: Well, the legislation, what it would do
24 is it would require a much more liberal entry policy for
25 resale in the state of California, which would, if the
26 Commission decided that it wished to restrict competition in
27 any way in the state, then the bill could -- For the purposes
28 of maintaining universal service, then the bill could become --

1 it could be contrary to that policy. And that would be the
2 argument for waiting. If you want to wait for the Commission
3 to reach a decision on the entire question of competition in
4 the industry, and it hasn't been decided in California what
5 the rules will be and what the policy should be, that might be
6 a more deliberate way to proceed.

7 CHAIRMAN ROSENTHAL: Well, on the other hand, you
8 know, when bills of this nature have major opposition, they
9 don't usually go very far anyway. It seems to me that perhaps,
10 and I haven't come to that decision yet, the bill ought to
11 proceed at least through the first couple of committees in
12 the House, and if there is major opposition, obviously it is
13 not going to happen in a second; and at least there would be
14 something going along at the same time as you may be having
15 your hearings.

16 MR. WYSE: Uh-huh. Well, what we will promise to do
17 is to keep you as informed as we possibly can as we reach
18 decisions, so you understand what the decisions are, and you
19 can analyze them and decide how you want to proceed. I think
20 that is --

21 CHAIRMAN ROSENTHAL: Thank you very much.

22 MR. WYSE: Thank you very much.

23 CHAIRMAN ROSENTHAL: Right.

24 Phillis Whittiker, District Manager of Network
25 Services of Pacific Telephone and Telegraph.

26 MR. HENRY: Mr. Chairman, our witness has not
27 arrived as yet. I wonder if we could postpone her testimony.

28 CHAIRMAN ROSENTHAL: Fine. All right.

1 Earl Forshee, Division Manager of American Telephone
2 and Telegraph Company.

3 MR. FORSHEE: Good morning again.

4 CHAIRMAN ROSENTHAL: Good morning.

5 MR. FORSHEE: AT&T's position on SB 375 is similar
6 to what Mr. Wyse just indicated in his testimony. We view
7 that resellers are both customers of AT&T and they are
8 competitors, and there may be opportunities and advantages
9 in that outlet in the post-divestiture mode of operation,
10 but we just don't know at this point in time.

11 AT&T supports the concept of competition; it is
12 beneficial to telephone customers. It also favors reduced
13 regulation of telecommunications service providers in instances
14 where no public interest is served by such regulation. The
15 treatment of resale carriers posed in SB 375 in its present
16 draft form raises several questions of important consequences,
17 we feel, which would argue against the enactment of this bill
18 at the present point in time.

19 First, I think SB 375 is premature, that it would
20 impose some substantial restrictions on the California
21 Public Utilities Commission ability to investigate and
22 ultimately regulate the resale function as an element of the
23 overall intrastate telephone structure.

24 As we talked about yesterday in our discussions,
25 there are many simultaneous proceedings under way right now.
26 We have got the FCC proceedings; we have got simultaneous
27 proceedings in the state of California in front of the
28 Commission. Industry representatives are participating fully

1 in those proceedings, as is AT&T and as is Pacific Telephone
2 and other members of the industry; and, of course, the
3 Commission itself is quite involved.

4 These are indeed technical issues. We have some
5 profound impacts, potentially. It is a little bit like
6 squeezing the balloon: If you look at just one element of
7 just one vector on the balloon, indeed the balloon is
8 going to go in there, and you will see a reaction. But there
9 is probably going to be a counter-reaction someplace in the
10 spectrum of telephone service, and it is important, I think,
11 that we examine what is happening very carefully. First of
12 all, you have to have information before you understand, and
13 you have to understand before you make a decision; and we are
14 suggesting that if we look at the issues in that simple one-,
15 two-, three-phased way of doing it, that the public at large and
16 the public interest will in fact be served.

17 As a consequence, then, of recent decisions, of
18 course, at the FCC, and the federal court in particular, and
19 the provisions of toll services becoming subject to competition
20 among service providers using different means - and there has
21 been considerable discussion on that: We have got owning
22 facilities, leasing facilities, resale of tariff services, and
23 combinations and permutations thereof. These actions, though,
24 do reserve to California and other states a residual ability
25 to determine appropriate levels of competition within the
26 serving areas in the State's jurisdiction, and of course the
27 California Commission is presently examining just exactly
28 this issue. And, in particular they are looking at the issue

1 of resellers, as well as the underlying issues such as the
2 impact of competition on existing rate levels and, very
3 importantly I think to all of us in the industry and all of
4 us in the public at large, the continued viability of
5 universal telephone service.

6 We basically have these large technical staffs -
7 that would go for AT&T's technical staff and the Commission's
8 staff - taking a look at these activities in a very
9 comprehensive way.

10 SB 375 would indeed preempt the Commission's full
11 consideration of the reseller issue if it were passed at this
12 point in time, and would impose some restriction on the
13 Commission's ability to deal with these issues. It would also
14 appear that in the near time frame we would expect some
15 precipitation out of the proceedings, and we would all be a
16 little wiser as a result of the experience.

17 We think that some relaxation of the PUC's rate
18 approval requirements may eventually be desirable. At this
19 point in time there are some vagaries associated with the
20 language of the bill - the issue of principal activity was
21 already raised this morning; that is also an issue that we
22 feel would require some -- perhaps a greater definition,
23 because many folks would engage as a principal in the course
24 of business, perhaps in the resale area, but if they also
25 owned a facility, at that point in time they would become very
26 much like other providers of service in the business; and we
27 would recommend to the Commission and to this Committee, in
28 fact, that carriers of long distance service be treated as

1 fairly and equally as possible. In the case of AT&T, it is
2 easy to think of AT&T as large and very much present in the
3 marketplace right now, but AT&T serves many types of interests
4 and types of customers in its present arrangement, and any
5 handicap imposed on AT&T ultimately is borne by AT&T's rate-
6 payers, which include to a large degree the rural, the occasional
7 user of telephone services, and the disadvantaged. They are
8 not able to seek out some of these other options because they
9 are not involved in that area of the cream of the telephone
10 serving market. So the main message, at any rate, is that
11 whatever happens has to make sure that we take a look at the
12 entire universe of Californians, and that the benefits of
13 competition would in fact be available to the large universe
14 of California.

15 In particular was some discussion about equal
16 access. And just to perhaps illustrate my point that it is a
17 good idea to wait until some of the judgments are made by the
18 pending activities: There really are differences of opinion,
19 I think, in terms of the availability of equal access. Right
20 now it is a very technical subject. And I can introduce the
21 subject of the technical interpretation of some of the
22 activities, but it really takes the technical staffs that are
23 formed and taking testimony in these proceedings to in fact
24 articulate these technical activities with greater detail.
25 But there was some concern expressed in the last couple of
26 days about problems of access, the lack of automatic number
27 identification, the lack of supervision, the difficulties
28 with transmission and rotary dial access, and some of these

1 kinds of things. The jury is still out in the current
2 proceedings over at the California Commission, but there is a
3 lot of testimony about just exactly this issue. And, in fact,
4 witnesses have presented testimony over at the California
5 Commission that says that approximately 60 percent of PTT's
6 customers today have offices -- are served by offices capable
7 of providing NVB origination.

8 NVB origination would in fact provide answer
9 supervision, rotary dial access, multi-frequency signaling
10 and transmission quality equal to that of AT&T's service.
11 And the various parties in the proceedings have made various
12 arguments about the significance of the NVB arrangement; and
13 it would be our view, I believe, and the view of several others
14 in the proceeding, that one reason the competition does not
15 select NVB is not because of a desire for equal access but
16 strictly price. It is cheaper from a price point of view to
17 subscribe to ENFIA right now, and they have to give up
18 something in the process of doing that. But it is to their
19 price advantage to do so.

20 The main message, again, is that these are compli-
21 cated subjects; they are under review by some very talented
22 folks. And it is my belief that in the very near future
23 we will know a little bit more about how prices are going to be
24 set in the state of California and what some of the serving
25 arrangements will be, and we will have a little clearer vision
26 about the impact on the basic subscriber and the impacts on
27 the universal telephone service. At that time, we would be
28 able to take additional actions.

1 CHAIRMAN ROSENTHAL: Do you know whether there is
2 any legislation currently being discussed in Congress relative
3 to the subject?

4 MR. FORSHEE: To the subject of resellers?

5 CHAIRMAN ROSENTHAL: Right.

6 MR. FORSHEE: I'm sorry, I don't know for a fact,
7 but we certainly could determine that for you.

8 CHAIRMAN ROSENTHAL: I don't know either, and I just
9 wondered whether there was any comparable legislation as 375.
10 You know, it would be kind of helpful if sometime in the near
11 future you or anybody else that has a theory on this particular
12 piece of legislation would suggest to me, perhaps, amendments
13 that would make it palatable. I'm a little concerned that
14 this is the second year of the two-year session. It is
15 difficult to get a bill through two Houses in that short
16 period of time that remains. So, that even if the PUC came
17 up with its regulations, which everybody was on board with,
18 and there was some interest in doing that in the statute, we
19 might run into a time problem.

20 I have thought about these proceedings for the first
21 Committee, just to get some give and take before the
22 Legislature, on the various issues, and then taking a look at
23 whatever is coming out of the PUC as to whether or not it is
24 in line, needs amendment or what have you. What do you think
25 of that concept?

26 MR. FORSHEE: I think that is consistent with my
27 recommendation. We are basically in an informational mode
28 right now; it's important to have all of the information before

1 one attempts to understand and one attempts to make a
2 decision; and it would appear to me that an exchange of
3 information would be in the best interest of all the parties,
4 and that certainly is quite the logical next step in my
5 opinion.

6 CHAIRMAN ROSENTHAL: Thank you very much.

7 MR. FORSHEE: Thank you.

8 CHAIRMAN ROSENTHAL: Did Phillis Whittiker, District
9 Manager, Network Services, Pacific Telephone and Telegraph
10 Company arrive?

11 MS. WHITTAKER: Yes.

12 CHAIRMAN ROSENTHAL: Welcome.

13 MS. WHITTAKER: I apologize for my late arrival; I
14 got hung up at LAX and my flight was canceled, and 405 had a
15 backup on the freeway. It seems as though Murphy were at
16 work this morning for me.

17 CHAIRMAN ROSENTHAL: Well, that is all right. Are
18 you relaxed so you can proceed?

19 MS. WHITTAKER: Well, I'll try.

20 CHAIRMAN ROSENTHAL: Very good. Thank you. Oh,
21 before we do, I want to announce that Senator Montoya has
22 joined the Committee. Good morning, Senator Montoya.

23 SENATOR MONTOYA: Shall I give my excuse for being
24 late?

25 MS. WHITTAKER: He was in the car ahead of me, I
26 guess.

27 SENATOR MONTOYA: Different directions; same problem.

28 CHAIRMAN ROSENTHAL: Same problem yesterday.

1 MS. WHITTAKER: I have a prepared text, but on the
2 other hand I heard Mr. Forshee talk about equal access. I
3 have been responsible for equal access planning in Pacific
4 Company, so if you would like to ask a few questions about
5 that at the end, I would be happy to entertain them.

6 My name is Phillis Whittaker, and I'm a District
7 Manager of Pacific Telephone's planning organization. I
8 appreciate this opportunity to talk to the Committee about
9 telecommunications resale and about Senator Rosenthal's bill,
10 Bill 375, specifically.

11 The unregulated resale of Pacific's telecommunications
12 services is a very great concern to us. The tariffs under which
13 the Pacific office gets services are based on usage and cost
14 projections developed after expansive study by my company and
15 by the California Public Utilities Commission.

16 As resale carriers attract more of our traditional
17 toll customers, these projections become inaccurate and the rate
18 structure envisioned by the California Commission is invalidated.
19 This will inevitably result in the upward pressure of our
20 regulated telephone lines. As Pacific moves into its new post-
21 divestiture telecommunications environment, we remain
22 committed to keeping basic telephone costs affordable and
23 universal. Any unregulated activity which siphons revenues
24 away from our regulated phone business makes it increasingly
25 difficult to make that commitment. We believe it is critical
26 to preserve the Public Utility concept of a single regulated
27 service supplier within the LATA and that diversion of intra-
28 LATA toll revenues should not be permitted.

1 While the activities of resellers do not constitute
2 bypass as we have traditionally defined that term, they do,
3 nonetheless, constitute a very real threat to the continued
4 provision of affordable telephone service. The basic issue
5 here is that resellers constitute a form of intra-LATA
6 competition to our toll services using Pacific's own facilities.
7 From Pacific's perspective there is no distinction between a
8 reseller of our services and a facilities-based carrier -
9 which we commonly call an OCC. In fact, there are facilities-
10 based carriers which presently engage in resale.

11 From a technical perspective, the primary difference
12 between an OCC - Other Common Carrier - and resellers has been
13 whether or not the carrier owns its own facilities. Both OCC's
14 and resellers provide switching and routing functions, and
15 both employ leased or tariffed lines obtained from various
16 communications providers. The difference depends on the
17 business strategy and the choice between owning and/or leasing
18 the transmission facilities. One is merely a substitute for
19 the other. The net effect on our revenues is the same: intra-
20 LATA competition drives up the cost of basic telephone service.

21 Even though that portion of SB 375 which would
22 require resellers to make themselves --

23 SENATOR RUSSELL: May I ask a question, please?

24 CHAIRMAN ROSENTHAL: Senator Russell has a question.

25 SENATOR RUSSELL: In your testimony will you
26 develop how it drives up the cost, if you will?

27 MS. WHITTAKER: Not in any great detail, but I can
28 talk about it.

1 SENATOR RUSSELL: Why don't you do it now, then.

2 MS. WHITTAKER: Okay. Our costs are based on cost
3 averaging with intra-LATA. It has been in the past, within
4 the state, and in the future, Pacific will only be in the
5 intra-LATA and exchange access business. That is our defined
6 regulated business as divestiture occurs.

7 In order to cost average, or to keep the cost of
8 basic service down, we depend on the intra-LATA toll revenues
9 to help subsidize the cost of local service. Those are the
10 revenues from intra-LATA service that the provider would take
11 away from us - the lucrative or the more lucrative intra-LATA
12 toll routes that now subsidize local service.

13 As a competitor, an intra-LATA competitor, siphons
14 off those profitable routes, then it leaves basic telephone
15 service having to pay more and more of the cost of providing
16 that service.

17 SENATOR RUSSELL: I guess I'm not really clear on
18 how the resale operator works. As I understand it, he buys
19 it cheaper by the dozen from you, and then sells that service
20 to other people at a price that is below what you would sell
21 to the individual. Is that correct?

22 MS. WHITTAKER: And, in doing so, siphons off that
23 individual's toll.

24 SENATOR RUSSELL: Is what I said correct?

25 MS. WHITTAKER: Yes.

26 SENATOR RUSSELL: So he provides that service to
27 certain customers in this area that find out that they can
28 buy service cheaper through them than through you; so they go

1 there. That leaves -- but he can't do that unless he buys
2 that wholesale from you, or in large amounts from you, I guess.

3 MS. WHITTAKER: What it does is, it leaves the
4 customers who did not go to the reseller to have to pay a
5 higher price for the services they buy from Pacific.

6 SENATOR RUSSELL: Why wouldn't they go to the
7 competitor, then?

8 MS. WHITTAKER: Well, that is probably the end
9 result: They will all go to the competitor for the toll
10 traffic they are offering, and then local basic telephone rates
11 would have to bill their own cost.

12 SENATOR RUSSELL: Basic rates, okay. So now you are
13 subsidizing these toll -- the toll fares are subsidizing the
14 basic rates of the local user.

15 MS. WHITTAKER: That's correct.

16 SENATOR RUSSELL: And if you carry it to the final
17 logical conclusion, and the competitors gobble up all of the
18 competition on these tolls, you will have --

19 MS. WHITTAKER: Only the high volume, lucrative toll
20 routes. They have not so far shown an interest in what we
21 consider extended-area service, or the free routes.

22 SENATOR RUSSELL: They cannot buy that from you and
23 resell it at a profit; is that correct?

24 MS. WHITTAKER: That's correct.

25 SENATOR RUSSELL: Okay.

26 MS. WHITTAKER: Part of the issue, as we see it, is
27 because Pacific will only be in the intra-LATA toll service.
28 We feel that intra-LATA toll -- that intra-LATA business should

1 be the regulated entity; it should not be open to competition.

2 Our issue with the resellers is that they are a
3 carrier as any other carrier and, if they are removed from the
4 regulation of the Commission, then the Commission would no
5 longer have the authority to determine whether or not intra-
6 LATA competition was appropriate.

7 SENATOR RUSSELL: Why is it that toll rates are so
8 lucrative and the local rates are so expensive?

9 MS. WHITTAKER: Well, that goes back to the -- it is
10 a hundred years of Bell System-type economics, where
11 long distance short calls - Chicago to New York - routes
12 subsidized Montana. It was an objective that in a regulated
13 environment you could perhaps sustain those kinds of cross-
14 subsidies.

15 Competition, on the other hand, takes the lucrative
16 routes and leaves the nonlucrative routes to have to bear
17 more of the cost of providing the service.

18 SENATOR RUSSELL: We have been through that with
19 Greyhound Bus Line, and so forth. Is this -- is this
20 historical situation based upon governmental interference and
21 regulatory -- is that how the subsidization thing resulted?

22 MS. WHITTAKER: I'm not personally a historian, but
23 I would suspect that it was the objective of the telephone
24 service nationwide that probably drove these kinds of
25 subsidizations in the first place.

26 SENATOR RUSSELL: And your position is - I won't
27 probably present it in the way you would present it - but,
28 basically, you are opposed to the resale carrier for the

1 reasons you stated, that it will -- they will skim off all
2 the cream and leave you with all the expenses, and that will
3 drive up your basic rates of having a telephone.

4 MS. WHITTAKER: We believe that that is the case,
5 yes.

6 SENATOR RUSSELL: So your position would be to some-
7 how or other change a regulation or prevent them from being
8 able to do this, or make them more competitive with you in the
9 local rates?

10 MS. WHITTAKER: You are really aware of what the --
11 with the investigation the Commission has been holding to
12 investigate whether or not intra-LATA competition is appro-
13 priate. Judge Greene's court has consistently said in
14 writings that they believe that local telephone rates and
15 intra-LATA competition was an issue for the local jurisdictions,
16 and we believe that that is appropriate also.

17 The problem that we see with this bill is that it
18 removes the reseller from the regulation of the utility -- of
19 the Public Utilities Commission, and we don't see any difference
20 between a reseller and an OCC or facility-based carrier in
21 that regard. We think that the California Commission should
22 be able to regulate a reseller in the intra-LATA business,
23 just as they are able to regulate an OCC.

24 SENATOR RUSSELL: Which is what you are.

25 MS. WHITTAKER: We're not an OCC; we are a basic
26 telephone --

27 SENATOR RUSSELL: But you are being regulated --

28 MS. WHITTAKER: Yes.

1 SENATOR RUSSELL: -- like the OCC?

2 MS. WHITTAKER: The Commission has the authority to
3 allow or deny intra-LATA competition for other carriers, and
4 we believe that resellers should be treated just like another
5 carrier in that regard.

6 SENATOR RUSSELL: So if the PUC would restrict their
7 activities, that would keep the price of these inter-LATA
8 fees higher?

9 MS. WHITTAKER: Probably. That is probably the
10 ultimate result. But what it does, it allows the Commission
11 to determine the destiny, so to speak, of intra-LATA
12 communications within California. It allows them to determine
13 whether it is better to let local services rise to pay its
14 own way, or whether it's better to continue with the system
15 of subsidization.

16 SENATOR RUSSELL: If your company would have its
17 way in this regard, would it not in effect counteract what the
18 divestiture is all about - competition?

19 MS. WHITTAKER: Well, I'm not an attorney, so I can't
20 give a legal opinion. A personal opinion is no, I don't think
21 so, because the Modification of Final Judgment defined the
22 Bell operating companies' business boundaries as being intra-
23 LATA and exchange access. And when we developed the LATA
24 boundaries and worked on the first LATA plans, it was with the
25 assumption on our part that intra-LATA was our business, and we
26 would foster competition in the inter-LATA work.

27 We felt that that was what the MFJ was all about,
28 was making all routes - like Los Angeles to San Francisco -

1 open to competition, but certainly not routes like -- I'm not
2 familiar with Southern California, so I'll have to say San
3 Jose to San Francisco.

4 We felt that that was defined as our business
5 boundary - the regulated business.

6 SENATOR RUSSELL: Thank you.

7 CHAIRMAN ROSENTHAL: Let me just follow up a little
8 bit on that. If the PUC were to regulate them, then they
9 would also determine perhaps what those companies had to pay
10 you for the use of your lines?

11 MS. WHITTAKER: Well, I believe that whether they
12 regulate them or not, I think they determined that our access
13 charge filing - assuming that the resellers would use our
14 facilities to terminate calls to the end user and not bypass
15 them completely. I'm assuming that they would purchase that
16 access out of our access tariff, which is approved by the
17 Commission; so what they pay us for terminating or originating
18 a call within our jurisdiction would be regulated by the
19 Commission; that would be whether or not the call was intra-
20 LATA or inter-LATA, I would assume.

21 There is much that is unknown about intra-LATA
22 competition. I would venture to guess that we would have to
23 revise the cost of our access charges if we were to provide
24 access on an intra-LATA basis, because the costs were derived
25 assuming it was inter-LATA access.

26 CHAIRMAN ROSENTHAL: What would prevent you from
27 raising those fees to those companies so that --

28 MS. WHITTAKER: Well, there is a school of thought

1 that says that if we make our access charges too high - charge
2 what the traffic will bear, so to speak - there would be
3 incentive to build facilities and bypass the local network to
4 heavy users anyway. And the concern that we have with that is
5 that they might bypass our network to Bank of America, United
6 Airlines, some big company, which would again remove the
7 subsidization and the cost averaging within those facilities
8 to create the couple down the street or your house or my house
9 that don't have the call volumes to justify or to encourage the
10 carrier to build a facility to our location, we would be left
11 to pay the full cost of the nontraffic sensitive plant that has
12 to be incurred. With any kind of a subsidization system, if
13 you peel off the more lucrative of it, then that leaves the
14 less lucrative piece that has to start bearing the cost of
15 its own service.

16 SENATOR RUSSELL: On that point, in addition to
17 having a local rate higher to support its own costs, would
18 that not then mitigate against large capital investments for
19 improvement and modernization as the telephone company has
20 been doing over all these years?

21 MS. WHITTAKER: I don't believe so, because most of
22 the large capital investments for modernization that we are
23 expending in the next couple of years are being expended
24 primarily to meet our requirements under the MFJ to provide
25 equal access to all carriers.

26 SENATOR RUSSELL: I'm talking about in 10, 15, 20,
27 25 years from now. There has been a constant modernization
28 of the telephone over a period of time, from the standup phone

1 to the squat phone, rotary and then the pushbutton, and then
2 direct dialing, and et cetera, et cetera. We have the finest
3 telephone service in the world. That takes a lot of capital
4 investment.

5 MS. WHITTAKER: Yes, it does.

6 SENATOR RUSSELL: And it would seem to me that if
7 people are screaming and yelling at the high costs of just the
8 local rates, it would make it difficult to raise the rates
9 high enough above that to continue the large capital invest-
10 ment to continually improve and upgrade your local service.

11 It might be where these more lucrative rates that
12 are skimmed off by these other companies would allow them to
13 continually improve their service, with the local telephone
14 service lagging farther and further behind. Is that a
15 possibility?

16 MS. WHITTAKER: I would think it is, yes. The
17 problem that I see with that is that if the local telephone
18 service lags behind, that is the access, that is the dial
19 tone, so to speak, that is provided to the customer. And to
20 put technology kind of in perspective, we can talk about
21 different types of obsolete kinds of telephone equipment -
22 the step-by-step switching machine provided dial tone and did
23 an adequate job for 50 years; and it was around for 50 years.
24 We still have some in service today. We are attempting to get
25 rid of them as fast as we can, but there are still some out
26 there. It was the next technology, and the stepper came into
27 being somewhere around the beginning of this century; and then
28 the next technology that was any significant change was the

1 cross-bar switch, which was in the late 30's. So you went
2 almost 40 years with one technology. And then the cross-bar
3 was replaced by the ESS in '65. And then today digital is
4 replacing ESS. Who knows what is next. The technology
5 window is getting smaller and smaller. So we really don't
6 know what is out there 15 years from now.

7 SENATOR RUSSELL: And the technology strides are
8 getting greater and greater and coming with greater frequency.

9 MS. WHITTAKER: But we do know that if in fact an
10 inter-exchange carrier, whether they are facilities-based or
11 whether they are reseller, we do know that they want to offer
12 the new zippy services that everybody is demanding today -
13 computer hookup, packet switching, and all of this kind of
14 thing that is digital activity; and if the end user is served
15 by an obsolete switching technology, they are not going to be
16 able to access the inter-exchange carriers' modern facilities.

17 SENATOR RUSSELL: Well, is there anything -- Let's
18 assume your wish does not prevail and everyone is skimming
19 everything off and you are left with the dregs and have to
20 support themselves. Is there anything in the regulations for
21 what might happen that would prevent you from charging these
22 other organizations a sufficient amount so that you could
23 continually upgrade your system, which would benefit the
24 local user as well as those who have -- need access?

25 MS. WHITTAKER: I think that that is a very real
26 possibility; that we would have to shift the cost of our
27 modernization of our plant to the carriers.

28 SENATOR RUSSELL: You could do that as far as you

1 understand the deregulation?

2 MS. WHITTAKER: I believe so. But the problem that
3 I see with that, as I said earlier, is if too much of the cost
4 is shifted to the carrier, then they are going to be encouraged
5 to bypass our local facilities entirely to the heavy users,
6 which will leave the light users left to pay the full cost of
7 the load.

8 SENATOR RUSSELL: Thank you.

9 CHAIRMAN ROSENTHAL: Please continue.

10 MS. WHITTAKER: While the activities of resellers do not
11 constitute bypass, as we have traditionally defined that term,
12 they do nonetheless constitute a very real threat to the
13 continued provision of affordable telephone service. The
14 basic issue here is that resellers constitute a form of intra-
15 LATA competition to our toll services using our own facilities.
16 From Pacific's perspective there is no distinction between a
17 reseller of our services and a facilities-based carrier. In
18 fact, there are facilities-based carriers which presently
19 engage in resale.

20 From a technical perspective, the primary difference
21 between an Other Common Carrier and resellers has been whether
22 or not the carrier owns the transmission facilities. Both
23 OCC's and resellers provide switching and routing functions,
24 and both employ leased or tariffed lines obtained from various
25 communication providers. The difference depends on the
26 business strategy and choice between owning and/or leasing
27 transmission facilities. One is merely a substitute for the
28 other. The net effect on our revenues is the same - intra-LATA

1 competition drives up the cost of basic telephone service.

2 Further, even though that portion of SB 375, which
3 would require resellers to make themselves known, would be of
4 some benefit to us from an engineering perspective, resellers
5 still present Pacific with the potential for significant
6 service degradation. Without becoming too technical, let me
7 explain that.

8 Our central offices are engineered on past history
9 and our forecast of the changes that we see coming, such as
10 added computer ports, heavy centrex growth, and percent business
11 increase or decrease. The equipment provided is designed to
12 accommodate this projected demand. To avoid service degrada-
13 tion, we must know when a particular customer is a reseller,
14 because their higher call volume has a definite impact which
15 must be taken into account when engineering the design limit
16 of a central office.

17 Knowing a reseller is going to come through a
18 particular office might help solve this problem of service
19 degradation, but there will be increased costs as we engineer
20 the office to accommodate the reseller's volume and the normal
21 day-to-day calls as well. These additional costs are not paid
22 by the resellers, but by all ratepayers. Again, the net
23 result is additional upward pressure on rates for a majority
24 of our customers.

25 The specific provisions of SB 375 allow for the
26 licensing of resale communications carriers by the California
27 Public Utilities Commission but do not allow the Commission
28 to regulate the rates, charges, operations or practices of

1 California's resale carriers. Being able to identify the
2 resale carriers achieves nothing if they still have the
3 unregulated ability to divert our toll revenues.

4 Further, the use of the term "principally" in the
5 definition potentially removes some of the largest resellers
6 from regulation as carriers. As I mentioned, there are several
7 facilities-based carriers which lease lines from Pacific and
8 then resell that service as part of their own network. This
9 Bill would appear to remove those carriers from any form of
10 regulation.

11 I would be happy to answer any questions you may
12 have. As you can appreciate, this is a very technical area,
13 and if I cannot answer your question now, I'll see to it that
14 you get an answer from the appropriate people.

15 CHAIRMAN ROSENTHAL: Any further questions? I think
16 we broke in on your testimony and asked many of them.

17 Thank you very much for your testimony.

18 MS. WHITTAKER: Thank you.

19 CHAIRMAN ROSENTHAL: Our next witness is Thomas
20 Quaintance, Revenues Director for General Telephone.

21 MR. QUAINANCE: Good morning. I won't take up too
22 much time, except to state that we agree with the position
23 taken by the California Commission, as Duncan Wyse put forward,
24 that the legislation really is unnecessary and premature until
25 the Commission has completed the investigation into intrastate
26 competition.

27 We think it is fully within the power of the
28 Commission to require licensing or regulation, or whatever,

1 of these resellers. That's all I'm going to say on that.

2 I would like to make an offer, again, from yesterday.
3 Before the other two senators arrived, we talked about a
4 briefing we had done in Sacramento on the 14th for some of
5 the consultants on access and bypass, and I would like to make
6 that available to any and all of you; if you would like us to
7 come - it is a very short thing, talking about access charges
8 and bypass and forms of bypass technology. And I can see that
9 your interest is increasing in these areas as you go through
10 these hearings. So through Tom Garcia you can get myself and
11 anybody else who would need to come and give that presentation.

12 SENATOR RUSSELL: May I make a comment?

13 CHAIRMAN ROSENTHAL: Yes, Senator Russell.

14 SENATOR RUSSELL: I raised that question yesterday,
15 and in talking with Mr. Davis, who was at that briefing, and
16 who got some feedback from other staff people who are not
17 knowledgeable at all in this field because it is not their
18 area, the comment was that it was extremely technical and
19 difficult to understand.

20 MR. QUAINANCE: Yes.

21 SENATOR RUSSELL: All I'm interested in for my staff
22 is the nuts and bolts of what is going to happen to the consumer
23 out there. He doesn't want to know how this all happened and
24 all the technical aspects and the terminology and so forth;
25 he wants to know what is going to happen to his telephone, and
26 where should he go to get a new one? What about service? If
27 he had some problems, what happens? How does he find out about
28 these other competitors, and what is his bill going to be, and

1 where does he complain, and all that sort of thing. Just
2 those basic, where-we-live, day-to-day answers is what I think
3 I want for my staff.

4 Now the technical aspects, the background, may be
5 helpful. But I would think that if you would not include
6 those basic nuts and bolts answers, which is the kind of stuff
7 our staff will get from those people out there who are
8 bewildered, confused and/or irate, or all three, you will not
9 be very helpful for us.

10 MR. QUAINANCE: Okay.

11 SENATOR RUSSELL: Okay.

12 CHAIRMAN ROSENTHAL: Thank you for your testimony.
13 Our next witness is Ms. Benj Jurcisin.

14 MS. JURCISIN: Thank you. I represent GTE-Sprint
15 Communications Corporation, and we would like to offer our
16 comments on this Bill. We believe that the concept of Senate
17 Bill 375 is sound, but that the Bill is too narrow in scope.
18 We believe that the Bill creates a new class of telephone
19 carrier called a "reseller," and it defines a reseller as one
20 who offers service to their customers through the purchase
21 and resale of other carriers' services; and, also, one that
22 has an insufficient market share or a power to control
23 prices, and is therefore considered a nondominant carrier.

24 Nondominant carriers are going to be subject to a
25 smaller degree of regulation as proposed in this Bill.

26 Dominant carriers possess monopoly control of the market or
27 an overwhelmingly dominant market share, which would still be
28 subject to regulation.

1 Sprint believes this bill ought to be expanded to
2 include carriers such as itself and MCI, who are similarly
3 nondominant in the marketplace. We believe that this Bill
4 could easily be amended to accomplish this by eliminating the
5 resale criteria in the Bill; and there are several reasons
6 that support this approach.

7 As others have commented today, the distinction
8 between resellers and specialized common carriers is becoming
9 less clear. Traditionally, resellers -- the traditional
10 definition of a reseller is becoming unclear. Now they are
11 beginning to own their own equipment, such as switching, and
12 building their own transmission facilities. Specialized
13 common carriers like Sprint and MCI are now using AT&T WATS
14 to resell services to terminating in cities that are not on
15 their network.

16 They also believe that the service provided by
17 resellers and specialized common carriers is transparent to
18 the telephone user, and therefore there is no difference in
19 the functional type of service provided to the user by either
20 class of carrier. We compete for the same customers, in other
21 words.

22 Any relaxed regulatory scheme that is proposed to one
23 type of carrier, we believe should apply to the other class
24 of carrier who is nondominant as well.

25 In summary, I would like to say that we believe that
26 the concept of a limited regulatory oversight for nondominant
27 carriers is a sound and reasonable concept. We believe that
28 nondominant carriers do not have enough market share or power

1 to control prices; therefore, we cannot drive competitors out
2 of the market. We will always be constrained from charging
3 an unreasonably high rate in our fear of losing customers.

4 I'll be happy to answer any questions.

5 CHAIRMAN ROSENTHAL: Any questions from the
6 Committee?

7 SENATOR RUSSELL: I'm sure, while your company is
8 not really involved in that it is not their concern, I'm sure
9 you are aware of the potential that if everybody strips out
10 the lucrative fields of service, leaving only the high cost,
11 unattractive, little-used areas, that the local telephone
12 service - those areas and the local residents - would be much
13 higher.

14 MS. JURCISIN: The cost of local service will be
15 much higher?

16 SENATOR RUSSELL: Do you agree with that statement?

17 MS. JURCISIN: Well, we believe that access charges
18 -- we believe that we are paying to the local phone company a
19 certain amount to access their local network. For use of
20 those facilities we pay \$237 a line.

21 SENATOR RUSSELL: You are not answering my question.
22 Do you agree with the statement made by the telephone companies
23 that, if everybody skims off the cream, so to speak, of the
24 business -- which is Sprint, MCI and the resellers are
25 proposing to do; and I don't say that that is necessarily bad -
26 that what is left will have to bear -- because it will not be
27 subsidized to the extent that it has been in the past, will
28 have to bear their own costs. Therefore, cost to the local

1 consumer, calling three blocks away or San Jose to San
2 Francisco, will be much higher. Is that basically a true
3 statement?

4 MS. JURCISIN: Well, we wouldn't agree with that
5 because we believe that we are, through our universal termina-
6 tion of calls using WATS, we are able to serve any customer
7 not on our network. So, in terms of where you can terminate
8 a call, we feel we can provide a service to users that are on
9 our network.

10 We also believe that we're paying the local phone
11 company for the use of their service, and in those access
12 charges that they will assess to us will be a reasonable
13 amount of money to recover any cost that they bear.

14 Another point that I think --

15 SENATOR RUSSELL: Costs that they bear for the
16 service they provide to you.

17 MS. JURCISIN: Yes.

18 SENATOR RUSSELL: Well, how about the cost that they
19 bear to the person that is not involved in your service? I
20 live in Glendale. If I call Burbank, it is not a toll call;
21 it is a local call.

22 MS. JURCISIN: Uh-huh.

23 SENATOR RUSSELL: If I buy your service to call
24 New York -- You don't provide service for me to call Burbank,
25 do you? Could I do it through your system?

26 MS. JURCISIN: I'm not familiar with the -- if it is
27 a toll call or not.

28 SENATOR RUSSELL: Let's assume it is not a toll call.

1 MS. JURCISIN: No, we do not provide a local
2 service, but --

3 SENATOR RUSSELL: I thought you said you provide
4 service like that.

5 MS. JURCISIN: We can terminate a call anywhere in
6 the United States using WATS resale.

7 SENATOR RUSSELL: In other words, if I go through
8 you, I subscribe to your service and I make a non-toll call
9 within the city of Glendale or from -- or to a neighboring
10 community, can I do it through your system?

11 MS. JURCISIN: No. Right now we have an application
12 before the PUC to provide an intrastate service. It is a
13 pending application.

14 We do -- We have made an application to serve that
15 market.

16 SENATOR RUSSELL: I see. I'm confused, because I
17 thought that was the purview of the local phone company.

18 MS. JURCISIN: Well, I see what you mean. No, it is
19 not a toll call. We would not be serving that.

20 SENATOR RUSSELL: All right. Now, if your company
21 and all the others -- You're in business to make a profit,
22 which I applaud. I'm a strong believer in a strong free
23 enterprise system, so these questions are not hostile. I'm
24 seeking information.

25 If you and the other companies are successful in
26 gobbling up all the profitable long distance toll calls, and
27 that will then leave the local Bell Telephone, General
28 Telephone companies with basically the unattractive, higher

1 cost service which has been historically subsidized in the
2 past by long distance rates. Okay? So those rates have been
3 kept low.

4 If the majority of the long distance calls, or toll
5 calls, are taken away from that revenue base, then those
6 people who are left, the person who makes a non-toll call to a
7 neighboring -- to a neighbor, will have to bear a higher
8 portion of the cost than he has in the past. So his rates
9 will go up.

10 Is that basically true, as far as you understand
11 the way the system will work?

12 MS. JURCISIN: It is not true, because we don't
13 believe that we have -- that it has ever been proven that the
14 subsidies -- that the long distance rates have subsidized a
15 local service.

16 The whole point of the divestiture of the phone
17 company is to drive costs -- rates of a service to what it
18 costs to provide it.

19 We don't believe that we are skimming the cream off
20 the market of toll calls. We believe that we use advanced
21 technologies in the same way that a local phone company will
22 be allowed to use those similar technologies for the cost
23 savings and the service to the customer that we are able to
24 provide. So we don't see it as a disadvantage, the new
25 technologies that are emerging.

26 SENATOR RUSSELL: Oh.

27 CHAIRMAN ROSENTHAL: Let me follow up on that.

28 SENATOR RUSSELL: I'm a little confused.

1 CHAIRMAN ROSENTHAL: I'm very confused, and I think
2 that -- Are you telling the Committee that the telephone
3 companies, under the new set-up with the access charges that
4 you and others will be paying, that their income will be the
5 same as it is now?

6 MS. JURCISIN: I'm not clear on what you mean by
7 "income."

8 CHAIRMAN ROSENTHAL: I'm talking about the total
9 amount of money that comes into the telephone company, which
10 heretofore has been providing all of these services. Will
11 the access charges --

12 MS. JURCISIN: The access charge, they should set
13 their access charges to recover the cost of providing the
14 service to us. Yes.

15 CHAIRMAN ROSENTHAL: That is not what I'm asking.
16 You're not listening.

17 MS. JURCISIN: All right.

4 18 CHAIRMAN ROSENTHAL: I'm not talking about the cost
19 of providing service to you; that is not what I'm talking
20 about. I want to know whether you are saying, because this is
21 part of the questions he raised. The telephone companies have
22 said that because of the divestiture, whether it be by you or
23 the others who are interested in this legislation that we are
24 talking about, that their income is going to be less, the
25 total pot of money is going to be less than what they are now --
26 before divestiture were receiving, and, as a result of that
27 being less - okay - they now have to pick up the additional
28 amounts of money from my home phone bill.

1 Is that true or not?

2 MS. JURCISIN: I guess I don't understand that,
3 because that is --

4 CHAIRMAN ROSENTHAL: Well, I think you are avoiding
5 the question. I really believe that.

6 SENATOR RUSSELL: No, I think she is confused.

7 CHAIRMAN ROSENTHAL: Well, I don't know that she is
8 confused.

9 SENATOR RUSSELL: I think she's paid by a company to
10 represent them, and that is what she understands. And I think
11 she is trying to relate to what her company does.

12 CHAIRMAN ROSENTHAL: That may be. Obviously, if the
13 number of dollars that came into the telephone company before
14 are going to be less --

15 MS. JURCISIN: That is the part that I don't under-
16 stand.

17 CHAIRMAN ROSENTHAL: Well, obviously it is going to
18 be less, because if you are doing long distance phone calling,
19 if you can sell your service, 30, 40 or 50 percent less than
20 what it is now costing for long distance, then obviously
21 fewer dollars are going to come to the telephone company.
22 Isn't that so?

23 MS. JURCISIN: But that is the competitive environ-
24 ment.

25 SENATOR RUSSELL: We agree with that.

26 CHAIRMAN ROSENTHAL: We agree with that. The question
27 is: If you can sell your services for 30 or 40 or 50 percent
28 less than what is now being charged by the telephone company

1 for that long distance service, then obviously the telephone
2 company has to then begin to compete with you on that long
3 distance. Okay?

4 MS. JURCISIN: If we are granted the authority to
5 compete with them for that service, yes, that is right. They
6 also have available to them the same technologies and means to
7 provide that service at a lower cost, as we have.

8 CHAIRMAN ROSENTHAL: Let me suggest to you that your
9 access charges --

10 MS. JURCISIN: So if we are more efficient --

11 SENATOR RUSSELL: You are talking about toll.

12 MS. JURCISIN: Yes.

13 SENATOR RUSSELL: You see, you haven't made the
14 mental shift to non-toll calls, which we are talking about.

15 MS. JURCISIN: Well, that is where -- I think that
16 what I'm saying is that the rates will recover the cost of
17 providing the local service.

18 SENATOR RUSSELL: Yes, because there will have to be
19 a increase to the local non-toll user; that is what we are
20 talking about. But we want to verify from you is, is that
21 your understanding.

22 Apparently you are a little muddled about that.

23 MS. JURCISIN: Well, I don't believe that there is a
24 connection there.

25 CHAIRMAN ROSENTHAL: The telephone company, in
26 providing universal service, has invested billions of dollars.
27 You are now going to be buying on to a portion of that for a
28 lot less than the investment of these billions of dollars,

1 yourself. Okay? And because of it, under the new technology,
2 you are able to provide long distance at a lower rate than the
3 telephone company is now charging for long distance. That is
4 what it's all about, isn't it?

5 SENATOR RUSSELL: See, we have been told by the
6 phone companies and it has been from the beginning our under-
7 standing through testimony by the PUC and others that because
8 of what is taking place, the telephone company historically
9 have subsidized the limited use, the non-toll calls, so that
10 everybody could have a phone. It kept the base lower than the
11 cost of providing that service.

12 MS. JURCISIN: We are not arguing that they have
13 subsidized it. What I think my company is arguing is that you
14 can't place that subsidy on long distance phone calls by
15 itself. The cash flow --

16 SENATOR RUSSELL: Well, that is what we are saying.
17 We are saying that because that high toll call will no longer
18 be because of competition, then that amount of subsidy that
19 was used before to keep the rates down for the local no-toll
20 user, it has to go up.

21 MS. JURCISIN: I guess I wasn't clear about who was
22 providing the subsidy that is in question. We believe --
23 maintain that it can't -- we haven't seen the figures that
24 prove that long distance calls have subsidized local calls;
25 that there are other cross-subsidies, internal to the Bell
26 System, that might point to another source of revenue for them
27 to keep the long distance -- or to keep local rates low. The
28 local phone companies --

1 SENATOR RUSSELL: Well --

2 CHAIRMAN ROSENTHAL: Yes. If you are suggesting,
3 and it may be that the telephone company will have to move in
4 the direction of charging more for the yellow pages, then
5 somebody is going to pay more because of the divestiture.
6 Some people will pay less and some people will pay more. And
7 the ones who are the larger users of long distance will pay
8 less, and the lowly homeowner consumer with his telephone is
9 going to pay more.

10 SENATOR RUSSELL: I don't think we are getting any-
11 where with her.

12 SENATOR MONTOYA: Let me see if I can try to explain
13 it in Spanish.

14 SENATOR RUSSELL: That would be nice.

15 SENATOR MONTOYA: I think what the Committee and the
16 world want to hear is that the "x" cost for the consumer for
17 long distance calls, the "y" cost for special services, and
18 the "z" cost for local service, is all going to amount to the
19 same after divestiture.

20 MS. JURCISIN: Yes.

21 SENATOR MONTOYA: I think it is ridiculous. I think
22 everybody in the world knows that is not likely to amount to
23 the same amount as before.

24 I think the marketplace has to shake things out, and
25 I think it has been our understanding that long distance has --

26 MS. JURCISIN: Yes.

27 SENATOR MONTOYA: -- provided some kind of a subsidy,
28 which I don't think you were making clear, to local service.

1 I think the truth of the matter is, and I think that
2 is the answer that they were seeking, is that, yes, it is
3 going to cost the local telephone user for local service, non-
4 toll service, more money, because the profit has been in other
5 areas. And that was the desired effect of divestiture.

6 MS. JURCISIN: Yes.

7 SENATOR MONTOYA: So I think really no matter how
8 hard we try, we have to give some time for the marketplace to
9 have its effect, and hopefully the competition to some extent
10 will keep the prices down --

11 MS. JURCISIN: Yes.

12 SENATOR MONTOYA: -- all those "x", "y", and "z"
13 services.

14 I think you didn't want to state to the Committee
15 that, yes, it is going to cost more for local service; and
16 that is the answer they were seeking.

17 MS. JURCISIN: Well, no. We have not been paying the
18 true cost of local service, and now with divestiture we will be.
19 But there are mechanisms in place to provide for universal
20 service, and that is what I thought --

21 CHAIRMAN ROSENTHAL: So you are saying, then, that
22 since we have not been paying the cost of universal telephones
23 at the consumers' level - at the homeowners' level - that
24 obviously those prices are going to go up.

25 MS. JURCISIN: Yes. We'll be paying the true cost.

26 CHAIRMAN ROSENTHAL: All right. That is what I was
27 trying to get at.

28 SENATOR MONTOYA: See how easy it is in Spanish?

1 CHAIRMAN ROSENTHAL: Do you have any other testimony?

2 MS. JURCISIN: No.

3 CHAIRMAN ROSENTHAL: Thank you very much. Let me --

4 SENATOR MONTTOYA: They are going to be coming to us
5 for help; that is what is going to happen.

6 CHAIRMAN ROSENTHAL: Let me go back and perhaps get
7 Duncan Wyse up here. About rates --

8 MR. WYSE: Okay.

9 CHAIRMAN ROSENTHAL: -- we understand what we think
10 we understand, which has been somewhat --

11 MR. WYSE: Okay. Let me try. The traditional cost
12 allocation in telecommunications was based on, in a monopoly
13 environment, allocated a lot of the local, fixed costs to long
14 distance rates. About half the cost of the local loop, your
15 basic line, telephone inside wiring, was allocated -- has been
16 allocated to toll service; and that provided a contribution
17 for local rates, and created the rate structure that we have
18 today.

19 As has been pointed out, if you continue to try to
20 maintain that rate structure in an environment of access
21 charges and competitive carriers, there is going to be an
22 incentive for those carriers to pinpoint the high volume users,
23 to avoid paying those high access charges; and, as they do
24 that, the support is likely to be eroded. So the regulators
25 have a difficult dilemma: If they try to get through access
26 charges on the long distance carriers, a lot of the local cost
27 out of those carriers, those carriers are likely to simply
28 bypass the local network entirely, and the support is gone.

1 On the other hand, if you charge low access charges, as the
2 carriers are advocating, then that means higher basic monthly
3 telephone rates.

4 The FCC access charge decision, which you probably
5 heard of - 7872 - essentially is moving costs back to the
6 local ratepayers. Over a five-year period it is going to add
7 to the monthly charge for telephone service on each customer
8 from about two dollars up to about eight or nine dollars over
9 the next five years or so, and lower the charges to the long
10 distance carrier. So you will see in the interstate market
11 lower long distance rates but higher access charges to the
12 customers. And that is really what is going on in the
13 industry with the competitive forces and the divestiture.

14 The issue that remains, really, is whether intra-
15 LATA competition should be permitted, and whether those same
16 forces will go on, if you permit intra-LATA competition, putting
17 more pressure on local rates. And that is the issue that is
18 before the Commission, what they're trying to decide.

19 SENATOR RUSSELL: Where is --

20 SENATOR MONTOYA: If I may, Mr. Chairman. I think
21 that some of the things that we are going to have to focus in
22 on as a Legislature, and for whatever the Public Utilities
23 Commission can regulate, while these market forces, you know,
24 shape themselves out, is to perhaps shift our focus to such
25 things as those little brochures that are going out in the
26 mail, and explanations that have been made to people, that
27 will indicate that you are going to be charged a minimum of
28 45 bucks. As is mentioned by the consumer advocate who was

1 here yesterday, any time you take in your telephone to have
2 the local phone company repair it, not getting notice as to
3 when they are going to discontinue your service, which has
4 always been something that has been done; they are going to
5 cut your service out, you get notified, therefore you get a
6 chance to pay your bill and not have the service disconnected
7 so that tomorrow they will charge you 15 or 30 or 40, to have
8 your phone service connected.

9 I think those are the kinds of criteria, the kinds
10 of considerations that we are going to have to make, to try to
11 protect some basic reasonableness, so as those market forces
12 out there are working against each other, they don't think
13 they can go to the consumer for the revenues they need to make
14 a profit. And that is a consideration. If things like \$45
15 for taking in any phone to have it repaired, or to not notify
16 the user before the service is disconnected and a reconnection
17 charge of whatever it is. And I think those are the kinds of
18 things we are going to have to focus in on. Some of the others
19 that are somewhat nebulous, I think that we are going to have
20 to give some time to the marketplace to take its effect, but
21 I think we have to make sure as, to some degree, we make sure
22 that, again, that all of the lost revenue, as this competition
23 is shifted around, doesn't accrue to the residential phone
24 user.

25 CHAIRMAN ROSENTHAL: Let me pick up on that. Are
26 you saying that the phone service may be cut off without
27 notification?

28 SENATOR MONTROYA: Well, that could happen, as has

1 been reported back to me. I think that could happen in the
2 future with deregulation.

3 CHAIRMAN ROSENTHAL: Can someone give us a handle on
4 that one?

5 MR. HENRY: Mr. Chairman, Paul Henry representing
6 Pacific Telephone. I am certainly unaware of that. I have
7 never heard of that, and I could probably state unequivocally
8 that we would never do that.

9 CHAIRMAN ROSENTHAL: That's good to hear. Thank you.

10 MR. WYSE: I just might point out that on the
11 regulated carriers, that under our franchise we do have
12 disconnection rules, and they are required to give notification.

13 There is the question you raised, though - that
14 consumers are going to be suprised on a lot of new charges.
15 And that is part of the confusion we talked about yesterday:
16 All of a sudden repairs for telephones and so on are much
17 higher than they ever expected. And that is a real problem.

18 SENATOR MONTTOYA: One of the other things, Mr.
19 Chairman. What about -- okay. As the marketplace takes over
20 and you can go buy your phone at Fedco or Gemco, or whatever
21 you want, somebody I think has to take the responsibility, or
22 we should give it to somebody about, you know, what a basic
23 phone is. Because you are going to be able to go out and buy
24 them for \$8.95 or \$99.95, and somebody has to be able to tell
25 the consuming public, or set down some guidelines as to at
26 least, you know, what is in that telephone. Something like,
27 you know, what the Underwriters Laboratories do with other
28 appliances, if you will. But I think that responsibility is

1 going to have to be somebody's, too; that as a minimum you
2 are buying a genuinely functional telephone.

3 CHAIRMAN ROSENTHAL: Thank you very much, Mr. Wyse.
4 Our final witness is Virginia Jarrow, Chairperson of the
5 Consumers Coalition of California.

6 MS. JARROW: I want to thank you for this opportunity
7 to appear. The first thing, Senator Rosenthal, I have from
8 Assemblyman Saul Garber of the California Legislature, a paper
9 on their priorities for October. And one of them is the
10 election of the PUC. And he wanted me to give this to you
11 personally.

12 CHAIRMAN ROSENTHAL: Who is this?

13 MS. JARROW: This is Assemblyman Saul Garber of the
14 California Senior Legislature.

15 CHAIRMAN ROSENTHAL: Oh, okay.

16 MS. JARROW: He says that he knows you from that
17 time that you had a Bill before the Assembly, and that I should
18 mention that he lived on Harper Avenue. Does that bring it to
19 your recall?

20 SENATOR RUSSELL: Where is Harper Avenue?

21 CHARIMAN ROSENTHAL: In my old district.

22 MS. JARROW: Is that what it is? I would like to
23 enter our paper into the record. Who do I give these to?

24 We wish to address the Senate Committee on the behalf
25 of the least represented people in these hearings, the end
26 user, the consumer who is not big business but residential or
27 the small business who are using but who are not part of a
28 sophisticated telecommunications network. We represent

1 consumer groups in both the North of California, in the
2 foothills of California, dependent on the independent telephone
3 systems who have testified before the PUC, and in the South
4 of California where longer distances and larger cities prevail.

5 We began as the California Tea Party in the North
6 who made an outcry on the capital steps when PG&E made huge
7 rate increases. We are also members of the Southern California
8 Utilities Protest Council who helped turn back the SCE rate
9 raises in the South.

10 We have consolidated into a Northern and Southern
11 division of the Consumer Coalition, and have liaison with
12 other major groups who are networking with us - groups to whom
13 we report on utility matters and who are deeply concerned with
14 the outcome of these hearings. We will be sending a report
15 to the State Agenda of the Grey Panthers, the Legislative and
16 Advocacy Council of the Los Angeles Council on Aging, the
17 Leisure World Consumer Affairs Council in Laguna Beach and
18 other groups statewide whose combined memberships give us a
19 representation of approximately one-half million people. We
20 are also networking with small business organizations who make
21 up the bulk of California business, not the largest companies
22 who can make their own solutions, but those companies who have
23 not the time to appear but who are the lifeline of the
24 California economy.

25 We have followed the PUC hearings and read the
26 transcripts. We were also recently at a seminar at which
27 consumer groups were being informed of what was coming after
28 divestiture. A young reporter from Ms. Magazine remarked that

1 she did not see what the upset was about. She had just come
2 recently from New York, and New York had had usage sensitive
3 service for years. I asked her what her bill was, inclusive
4 of all charges, per month. She answered, "\$17 average."

5 Now, I don't know about you, but \$17 sounds just
6 fine to me. My basic rate is 7.75, and if that sounds too
7 good to be true, it is. I have not yet been able to coax my
8 friends and acquaintances to live within my flat rate calling
9 range. So that means zone unit calls and toll calls which add
10 up to \$28 to \$40 per month. Now, if General Telephone gets
11 the rate increase they are asking for, my base rate will
12 double, and the toll charges will begin from the first moment
13 of usage. My telephone is no longer a convenience; it is a
14 liability - even if a necessary liability. Now, we are told
15 that to compete with MCI and Sprint, et cetera, we will have
16 to pay an access charge which amounts to two dollars to \$9.95
17 for residential, and six dollars to whatever for businesses.

18 If we cannot keep up these charges, we will have to
19 drop out of the network. The Rand Corporation, Dr. Johnson,
20 made these statements, by the way:

21 "The major telephone companies must make price
22 concessions to the large users so that they will not drop out
23 of the telephone network. The users threatening to leave the
24 network are customers like the State of California,
25 municipalities, cities and major corporations."

26 There appears to be a problem with the logic of this
27 approach. If, in order to compete with MCI and Sprint and
28 others, more and more financial burden is being placed on the

1 individual consumer, then more and more customers are going
2 to be forced out of the network; and I am not addressing
3 universal service and the subsidized customer, but the customers
4 in the middle, the ones who are paying for the basic services.
5 If enough are forced out of the competitive climate by impossible
6 telephone rates in the state of California, these people will
7 have no choice but to bypass the existing systems.

8 The telephone companies keep addressing flat rate
9 charges in these hearings, when this is not the existent
10 problem, as we understand it. We are stating that a substantial
11 amount of our utilities budget will have to be paid to the
12 telephone services. With access charges, we will find no cost
13 relief with the long distance carriers.

14 At the PUC hearings, a great deal of this testimony
15 was directed to the necessity of dropping from the network,
16 those who cannot afford the service. Yet, at the same time,
17 Pacific Telephone and General Telephone are saying that in
18 order to compete with the long distance carriers, we must have
19 revenue from our customers. Is this not a dichotomy? The
20 phone companies drive the people from the services with
21 excessive charges, so they can keep major users from leaving
22 the network by special cash incentives. Then they overburden
23 the remaining customers who, not being able to install his or
24 her own telephone system, has to use the existing system.

25 SENATOR RUSSELL: May I stop you there for a minute,
26 please?

27 MS. JARROW: Yes.

28 SENATOR RUSSELL: What you are saying does sound like

1 a dog chasing its tail --

2 MS. JARROW: Yes.

3 SENATOR RUSSELL: -- with the local people being the
4 unhappy recipients of the fallout.

5 MS. JARROW: Yes.

6 SENATOR RUSSELL: The problem is, I think it is a
7 very real threat, that if the telephone company charges the
8 large access companies amounts sufficiently high enough,
9 that may be an inducement to them to build their own
10 facilities and completely bypass the phone company - pay no
11 access charges whatsoever - and therefore everybody else that
12 is left will have to take up whatever slack that is involved.
13 And that means you and I as local users. So there is merit
14 to their recognizing that they have to keep the large business
15 users reasonably happy.

16 It sounds like, to you and me, that that is
17 favoritism at my expense; but I think that although it
18 probably is, it is a long view favoritism. The short view
19 would be to say, well, that is not fair, we are going to sock
20 it to them; and then have them leave; and in the long term,
21 the total cost to us who are left would be even higher. So
22 you've really got a serious problem. It is easy to say that
23 it sounds terrible - and it does - but unless you look beyond
24 that, it seems to me the situation could be worse.

25 MS. JARROW: Well, that is exactly the point we are
26 making: From the testimony that we heard and from the
27 transcripts that we read, that is a situation that is absolutely
28 impossible, and that any decision they make, the PUC, is going

1 to be a wrong decision; because even people that are impacted,
2 like the small customer, can eventually get smart enough to
3 say, hey, I'm going to use long distance, too - MCI. And
4 somebody is going to get the idea of sending a telephone call
5 out to Arizona and back long distance to San Francisco when
6 you are calling from Los Angeles. And we are going to find --
7 we're really not on the side of the major telephone companies.
8 But we are going to find Pacific Telephone and General
9 Telephone in a worse state than they are now. Because it
10 isn't going to be too long before the smart businessman does
11 that.

12 SENATOR RUSSELL: What are you recommending?

13 MS. JARROW: I think there has to be a control. I
14 really do think there has to be a control on what the MCI and
15 Sprint and what the others are allowed to do in having access
16 into the state of California.

17 The other thing we see --

18 SENATOR RUSSELL: Would you advocate a law that would
19 prevent them from setting up their own system, if that were
20 financially advantageous to their users?

21 MS. JARROW: No.

22 SENATOR RUSSELL: Well, that is what would happen,
23 if there is control to access and rates increase, to help the
24 little fellow.

25 MS. JARROW: Couldn't there be a period of transition?
26 Couldn't there be a period -- Well, I know I have been to some
27 seminars of Pacific Bell - General Telephone hasn't approached
28 us yet. But we have seen that they are making attempts to

1 become competitive. But it looks like it is going to take
2 approximately five years.

3 In those five years, if we have people coming in and
4 creating this competition -- and I'm not talking for them; I'm
5 talking for the people in the foothills. For instance, it is
6 true I tried to call Stinson/Pismo Beach. We have tried to
7 network with our people up in the foothills. We can't network
8 with them because MCI doesn't want that business. Sprint
9 doesn't want that business. The other ones coming in, they
10 don't want that business. And they don't want the cost of those
11 lines. They don't want any part of paying for the cost.

12 Maybe there should be a charge to them. Maybe there
13 should be a charge to them to support the local network until
14 we have a competitive climate here, to help support it.

15 SENATOR RUSSELL: Well, we may be able to do that,
16 but I think the ultimate result is -- that is where I was
17 coming from in the beginning. But the PUC and the other people
18 are saying, and the telephone people are saying, that if you
19 make that charge for that access service sufficiently high
20 enough to take care of people in the foothills and so forth,
21 and to keep the rest of our phone rates down, then shortly they
22 will decide to set up their own network completely independently.
23 For those who are left if that happens, they will be in a worse
24 position financially than we are if they don't go out. But,
25 the rates will still go up for the locals.

26 It's kind of a damned if you do and damned if you
27 don't situation.

28 MS. JARROW: Well, yes, that is what we saw when we were

1 listening. We saw what was happening. Is it possible to
2 stop the people from -- let's see. You can't stop open
3 competition. But what we see is that it isn't open competition;
4 they are using Pacific Telephone's lines. They are using
5 facilities that belong to General Telephone.

6 It isn't really open competition. They are buying
7 a service and selling it cheaper than the person that is
8 maintaining that service, maintaining the lines. And that is
9 going to impact on us, because -- I'm not going to read the
10 rest of this paper in its entirety. I'm just going to explain.

11 It means that -- Rand estimated that two-thirds of
12 the customers -- one-third would drop off, and then another
13 two-thirds would drop off. And that is the way it should be,
14 because in the shakedown, Dr. Johnson says, the people that were
15 left would be the important people to California. That is not
16 true. California's built on the small businessman and the
17 entrepreneur. California is built on consumer networks, which
18 has been very powerful. And we are seeing the destruction of
19 it if we don't change our thinking. And the PUC, in these reams
20 of testimony, has not been offered a solution, sir.

5 21 SENATOR RUSSELL: Well, if you happen to see Solomon
22 wandering around, we can use his wisdom.

23 MS. JARROW: I did have a suggestion which, being
24 as how the paper is entered into testimony, that possibly a
25 circle could be set up that consumers and the PUC representa-
26 tives, the major telephone companies, those that are coming
27 into the system now like MCI and Sprint, might get together
28 in round-table sessions and talk; and that there might be a

1 resolution arrived at this way. Much as we used to do in
2 advertising, which was you just raise the flag and saw who
3 saluted. And I think it has reached that point where every-
4 body, from what I heard here this morning, is saying their
5 particular problem, but nobody is addressing the entire issue.
6 And that includes me. It really does.

7 Are there any other questions?

8 CHAIRMAN ROSENTHAL: Thank you very much. I have a
9 question which probably should have been asked yesterday,
10 having nothing to do with this particular subject. But
11 because a number of us on the Committee are also on another
12 committee - Industrial Relations - I would like to know,
13 because the question came to me today. In this whole problem
14 of divestiture, obviously the telephone companies are going to
15 perhaps require fewer employees.

16 Have the companies done anything about that particular
17 problem in terms of their workers? Would anyone like to just,
18 off the record, comment about that?

19 MR. CARR: I'm Dick Carr. I testified earlier. In
20 part to that question and in part to some other things that
21 we have been talking about, it almost is as if we were thinking
22 of the long distance pie - all those revenues being a static
23 amount. It is as if they were not growing, and yet they are
24 growing very rapidly. It has been one of the most rapidly
25 growing businesses in the United States. Depending on whose
26 studies you look at, the total minutes of the total amount of
27 long distance going on is growing at like a 10 to 15 percent
28 rate per year. So, with that growth, there needs to be a

1 number of people in the industry, unless technology or other
2 reason drives that number down. But I doubt just the advent of
3 MCI and the other competitors would knock down the employees,
4 because that pie is growing so rapidly.

5 MR. QUAINANCE: Only totally. We will have fewer
6 employees over the next several years. And currently there is
7 extensive retraining going on of existing employees, to place
8 them in other areas where we might have gradual attrition of
9 skills. So people previously who install telephones might now
10 be in the construction area, building lines and cables and
11 things like that.

12 We have offered early retirement incentives for
13 people near retirement age. So we are very much aware that we
14 will generally have fewer employees in the future than we have
15 today.

16 CHAIRMAN ROSENTHAL: I see.

17 MR. QUAINANCE: But things are being done to take
18 care of retraining or out-placing existing employees.

19 CHAIRMAN ROSENTHAL: Did that subject come up in your
20 just recently concluded bargaining with the employees?

21 MR. QUAINANCE: I'm not personally familiar with it.
22 I'm certain that it was at least part of it.

23 CHAIRMAN ROSENTHAL: I understand that this has
24 nothing to do with this hearing, but we do sit on other
25 committees.

26 MR. HENRY: Mr. Chairman, Paul Henry again for
27 Pacific Telephone. Like General, we have offered early retire-
28 ment to some of our employees, with an incentive plan. And

1 when we divest, the people go with the job. That is, if they
2 are presently in an occupation that is related to AT&T, they
3 would go with AT&T; if their job is related to Pacific, they
4 would stay with us. Also, in the recently concluded bargaining
5 - I haven't read the agreement - it is my understanding that
6 there was a clause in there dealing with retraining of
7 employees due to the increase in technology in the industry.
8 I would be happy to give you that agreement, if you wish.

9 CHAIRMAN ROSENTHAL: At some point I would like to
10 take a look at that.

11 If there is no further questions -- is there anybody
12 who has not testified who would like to add anything to the
13 testimony?

14 (No audible response.)

15 CHAIRMAN ROSENTHAL: If not, I want to thank everyone
16 for having attended. I appreciate the input these last two
17 days in terms of this particular important subject. This
18 session is adjourned.

19 (Thereupon, the interim hearing for the
20 Senate Committee on Energy and Public Utilities was
21 adjourned at 11:39 a.m.)
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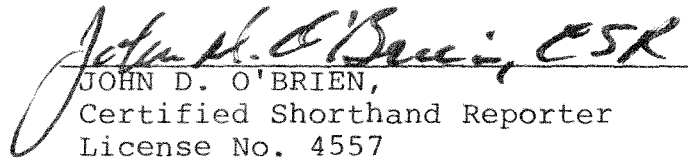
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That I am a disinterested person herein; that
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Hearing was reported in shorthand by me, John D. O'Brien,
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I further certify that I am not of counsel or
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IN WITNESS WHEREOF, I have hereunto set my
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